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by Rita Gunther McGrath

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Reprint

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Companies that rely on innovation for growth — that view the development of new products and services as their métier — must learn more than most to live with failure. For all the effort put into developing and marketing fresh ideas, many projects, particularly the bold ones, are unlikely to achieve commercial success or emerge as major growth drivers. Indeed, studies have shown that it takes as many as 3,000 raw ideas to result in one commercial success.

But lack of commercial success does not have to be a terrible result. If you keep your disappointments cheap, you can afford a lot of them. First you have to be able to separate the winners from the losers. To do that, Ian C. MacMillan, the Dhirubhai Ambani Professor of Innovation and Entrepreneurship at the Wharton School, and I have created a "barebones" net present value (NPV) calculator (available at www.discoverydrivengrowth.com) that assesses such factors as launch time, ramp-up time, competitive response, total investment, and projected annual costs and sales. This analysis, which can be revisited repeatedly during a project's development, provides a simple way to compare innovation initiatives in a company. If a project consistently produces a negative NPV, continued funding cannot be justified and a graceful ending is warranted.

We call this process "pruning." Just as a fruit tree yields more if its old, low-yield branches are trimmed back, so a business intent on growth needs to cut projects that are not promising. The goal is to shift resources from unproductive activities to higher-priority, more attractive opportunities. Because so much effort is required to get a project started, however, companies are often tempted to keep going, even after the project's early promise has deteriorated. This temptation escalates as the investment of time, energy, and resources increases. The tragedy is that the energy of good people and the effectiveness of the organization can be compromised when innovators become trapped in what venture capitalists call "living dead" projects.

Project escalation often derives from the best of intentions. Researchers have identified three major sources of entrapment in a failed initiative: psychological entrapment, in which team members feel personally committed to staying the course; rationalized entrapment, in which team members feel that success is just around the corner; and social entrapment, in which team members are reluctant to withdraw from a project because of commitments they have made to one another and to outside parties. A simple way to determine if the team is trapped is to ask each person in the group to anonymously agree or disagree with a series of statements. These statements can explain why smart, successful people might consciously or unconsciously have continued committing their talent and resources to projects that reasonably should have been shut down. They could include:

- I feel we will lose the respect of others if this project is shut down.
- Stopping this project would have a negative effect on my career or that of other team members.
- We made a public commitment to this project, and it would look bad to break it.
- We've made commitments to outside parties (investors, suppliers, distributors, customers) and inside parties (directors, management, other divisions, employees), and we cannot or should not break them.
- We have had some good results and are at a turning point; it would be premature to stop now.
- At this point, it would cost us more to stop than it would to finish.
- People who want us to fail (rivals, competitors) will gloat.

If most of the group's members agree with about a third or more of the statements, the team is at risk of escalated commitment. In that case, we suggest you have a frank discussion with team members about the various pressures that have little to do with the commercial promise of their project, and that may be clouding their judgment. You'll have to tell them that some tough calls will be made about the project, but they will be made as thoughtfully and gracefully as possible.

Indeed, disengaging from a failed project is not as easy as merely hanging a "closed" sign on a door. It requires delicately balancing the emotional commitment many team members have to a project with the business logic behind the decision in a way that salvages their pride, shows respect for their hard work, helps the organization learn important lessons, and maintains the reputation of the company.

To discontinue a project, develop a disengagement plan. It's just as important as the business plan you created to set up your growth initiative. But perhaps because people are so averse to failure, the disengagement plan is often neglected, resulting in lost value and much more misery than necessary. The disengagement plan should be short (five pages at most) but well crafted, a document developed by the venture team in conjunction with senior managers. It should formally address two critical issues.

1. Damage control. List all the stakeholders who will be disappointed by the disengagement — from investors to suppliers to prospective customers who have indicated interest in the product or service. Then, specify what each disappointed party is hoping for but will not receive. Next, list steps that could be taken to mitigate the disappointment. (Your team may have an erroneous perception about stakeholder disappointment, so be sure to check these expectations before you expend any effort fixing what is not broken.) Mitigation could involve simply apologizing to stakeholders for failing to meet their expectations or, more dramatically, making formal restitution. Specify who is responsible for ensuring that particular stakeholders have come to terms with the project's demise. And finally, leave room in this list for a "closure" notation, indicating that the stakeholder is satisfied. This is important because people tend to avoid or postpone the unpleasant task of damage control; diligent monitoring is necessary to ensure that the project is concluded.

2. Exploit positives. Begin with an after-action review, in which your team catalogs lessons learned from the project experience. Take each major aspect of the project — for example, customers, sales channels, technology, and processes — and document your original assumptions, the information on which they were based, and what has been learned. This analysis provides the backdrop for an opportunity review, during which the team can unleash its creativity by brainstorming possible applications for what has been learned. These could involve knowledge transfers to other divisions, customers, and partners, as well as commercial possibilities, such as spin-offs, licensing programs, and joint ventures.

In performing this exercise, you can recoup much of the effort and expense that went into the project and recoup morale, too. If your team members can end the project recognizing that it was the project, and not them, that did not succeed, you will have considerably rebuilt any lost confidence. You could also gain serious economic benefits from this analysis: M.A. Maidique and B.J. Zirger's 1985 study of major product innovation successes traced these triumphs to what the firms had learned from earlier failures. Among the triumphs was the genesis of the Thunderbird and the Mustang from Ford Motor Company's Edsel fiasco and the development of the popular IBM System/360 mainframe from the Stretch computer, which failed to meet aggressive performance estimates.

Failure to produce a disengagement plan has generated huge opportunity losses in companies that could have gleaned major gains from scuttled projects. In one bank that we analyzed, management shut down a project when problems elsewhere in the company made it difficult to continue funding it. In essence, the project managers then "turned off the lights and shut the door." Senior management never realized, nor did anyone tell them, that the project had left behind a revolutionary technology for transmitting vast amounts of data using signal compression, a technology at least seven years ahead of its time. The Internet came into commercial use six years later, and today, fast data processing is key to the business model of many rapidly growing firms. Huge profits could have been reaped if the bank had licensed the technology, if only someone there had paid enough attention to careful disengagement to think about it.

Trying and failing go together with innovation-led growth. The companies that get better at graceful endings will have a clear edge over those that continue to flounder when things don't go as expected.

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